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# EDITED TRANSCRIPT

MFC.TO - Q1 2014 Manulife Financial Corporation Earnings Conference Call

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**OVERVIEW:**

MFC.TO reported 1Q14 net income of CAD818m.



## CORPORATE PARTICIPANTS

**Anique Asher** *Manulife Financial Corporation - VP of IR*  
**Donald Guloien** *Manulife Financial Corporation - President and CEO*  
**Steve Roder** *Manulife Financial Corporation - SEVP and CFO*  
**Bob Cook** *Manulife Financial Corporation - SEVP and General Manager, Asia*  
**Craig Bromley** *Manulife Financial Corporation - SEVP and General Manager, US*  
**Cindy Forbes** *Manulife Financial Corporation - EVP and Chief Actuary*  
**Marianne Harrison** *Manulife Financial Corporation - SEVP and General Manager, Canada*  
**Rahim Hirji** *Manulife Financial Corporation - EVP and Chief Risk Officer*

## CONFERENCE CALL PARTICIPANTS

**Joanne Smith** *Scotiabank - Analyst*  
**Mario Mendonca** *TD Securities - Analyst*  
**Darko Mihelic** *RBC Capital Markets - Analyst*  
**Robert Sedran** *CIBC World Markets - Analyst*  
**Tom MacKinnon** *BMO Capital Markets - Analyst*  
**Humphrey Lee** *UBS - Analyst*  
**Steve Theriault** *BofA Merrill Lynch - Analyst*  
**Peter Routledge** *National Bank Financial - Analyst*  
**Doug Young** *Desjardins Capital - Analyst*

## PRESENTATION

### Operator

Good afternoon, and welcome to the Manulife Financial first-quarter 2014 financial results conference call for Thursday May 1, 2014. Your host for today will be Ms. Anique Asher. Ms. Asher, please go ahead.

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### Anique Asher - Manulife Financial Corporation - VP of IR

Thank you and good afternoon. Welcome to Manulife's conference call to discuss our first-quarter 2014 financial and operating results. Today's call will reference our earnings announcement, statistical package, and webcast slides which are available in the investor relations section of our website at Manulife.com. As in prior quarters, our executives will be making some remarks. We will then follow with a question-and-answer session.

Today's speakers may make forward-looking statements within the meaning of Securities legislation. Certain material factors or assumptions are implied in making forward-looking statements and actual results may differ materially from those expressed or implied. For additional information about the material factors or assumptions applied, and about the important factors that may cause actual results to differ, please consult the slide presentation for this conference call and the webcast available on our website as well as the Securities filings referred to in the slide entitled caution regarding forward-looking statements.



We also have a note to users slide that sets out the performance and non-GAAP measures used in today's presentation. When we reach the question-and-answer portion of our conference call, we would ask each participant to adhere to a limit of one or two questions. If you have additional questions, please re-queue and we will do our best to respond to all questions.

With that, I would like to turn the call over to Donald Guloien, our President and Chief Executive Officer. Donald?

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**Donald Guloien** - *Manulife Financial Corporation - President and CEO*

Thank you, Anique. Good afternoon, everyone, and thank you for joining us today. In responding to investor feedback, we are going to avoid the rote introduction of everyone at this meeting and for all future calls and allow more time for questions and answers. So Steve and my remarks will be far more abbreviated.

This morning we announced our first-quarter 2014 financial results. We had a very solid start to the year. Our strategy is unfolding into strong operating results and we are making measurable progress towards meeting our long-term objectives.

Let me start by reviewing the progress made in our growth strategies in the first quarter. We continue to develop our Asian opportunity to the fullest. In the first quarter we saw improved momentum in insurance sales with a very significant increase in Japan and double-digit sales growth in most of the other territories in Asia. This was largely the result of new product launches and increased marketing efforts in the region as well as the growth or distribution capability.

Wealth sales continue to be at levels seen in the second half of the year but were down from the first half of the year, as rising interest rates and market uncertainty impacted some markets in Asia.

We also continued to grow our wealth and asset management business globally. We achieved our 22nd consecutive quarter of record funds under management. Manulife Asset Management reported particularly strong results with record institutional advisory assets under management, new mandates in Asia and North America, and the majority of public asset classes outperforming on a one-, three-, and five-year basis.

Our balanced Canadian franchise continued its steady progress and in the first quarter, we had continued momentum in mutual funds, strong group pension sales, which drove record wealth sales. Retail insurance sales increased due to our actions to improve our competitive positioning and Manulife Bank slowed somewhat in light of tightening consumer credit and aggressive rate competition.

In the United States, we continue to drive sustainable earnings and opportunistic growth. We achieved our 10th consecutive quarter of positive net mutual fund sales and reported record sales and funds under management in our mutual fund business. Our retirement plan services sales declined reflecting competitive pressures; however, we reported meaningful sales of our new midmarket products. That is very good.

Our insurance sales slowed in the first quarter due to pricing actions taken last year. However, we expect recently introduced product enhancements and more competitive prices to improve sales.

Turning to slide 6 and in the financial highlights of the first quarter, we reported net income of CAD818 million reflecting core earnings of CAD719 million, and strong investment-related experience. I am particularly pleased with Asia's core earnings this quarter which are up 18% from last year's on an apples-to-apples basis when properly adjusted for factors such as currency, geography of hedging costs on our financial statements, and the sale of the Taiwan insurance business.

On the topline, we achieved wealth sales of CAD13.8 billion, up 5% over the first quarter of 2013. Insurance sales of CAD537 million were down 15% from a year ago largely reflecting lower sales in the Canada group benefits business. Excluding group benefits, sales increased 4%. We ended the quarter with a very healthy capital ratio of 255% and as I mentioned previously, achieved our 22nd consecutive quarter of record funds under management.

In summary, our plan is unfolding very well and we are confident that our growth strategies will continue to yield results for our shareholders.



And with that, I will turn it over to Steve Roder, who will highlight our financial results and then open the call to your questions. Thank you.

**Steve Roder** - *Manulife Financial Corporation - SEVP and CFO*

Thank you, Donald, and good afternoon, everyone. Let's start on slide 8, where we summarize our financial performance in the first quarter of 2014.

As you can see, we had a solid start to the year and performed well compared with a year ago on our key performance indicators for profitability, growth, and financial strength. In the following slides, I would address each of these indicators in further detail.

Turning to slide 9, you can see that we continue to demonstrate measurable progress on growing our core earnings. For the first quarter of 2014, we generated CAD719 million of core earnings, an increase of CAD34 million versus the prior quarter, driven by lower expenses, the favorable impact of currency and higher fee income, partly offset by a CAD64 million unfavorable swing in policyholder experience.

Turning to slide 10, in the first quarter, our reported net income benefited from continued strong investment-related experience of CAD275 million, CAD50 million of which was included in core earnings. This was partly offset by the negative impact of market-related factors totaling CAD90 million and CAD40 million in actuarial model refinements.

On slide 11 is our Source of Earnings or SOE analysis. Expected profit was largely in line with the prior quarter on a constant currency basis as higher fee income and lower amortization of deferred acquisition costs were largely offset by lower PfAD releases in our variable annuity businesses due to higher markets and the implementation of the managed volatility program, the impact of additional dynamic hedging in Japan at the end of the fourth quarter and the sale of our Taiwan insurance business last year.

New business strain was negatively impacted this quarter by lower volumes of insurance sales in the US. Experience gains include the favorable impact of our investing activities, partially offset by unfavorable policyholder experience and market impacts. Management actions this quarter reflect actuarial model refinements and expected macro hedging costs which decreased in the first quarter.

Turning to slide 12 and insurance sales, insurance sales of CAD537 million declined 15% over the prior period. The decline largely reflects our disciplined pricing actions and normal variability in our market-leading Canada Group Benefits business. Excluding Group Benefits sales, insurance sales grew 4% over the first quarter of 2013.

Despite the overall decline in insurance sales, insurance new business embedded value increased 15% over the prior year, reaffirming that the profitability of our new business continues to improve.

On slide 13, you can see that we have achieved wealth sales of almost CAD14 billion. Wealth sales grew 5% from a year ago, reflecting record mutual fund sales in North America and strong pension sales in Canada, which more than offset a decline in Asia wealth sales. Wealth new business embedded value of CAD135 million was in line with the prior year.

Turning to slide 14, funds under management at the end of the first quarter were CAD635 billion, our 22nd consecutive quarter of record funds under management.

Slide 15 indicates the capital position for The Manufacturers Life Insurance Company and our financial leverage ratio. We ended the quarter with a regulatory capital ratio of 255%, up 7 points from year end. Five points of the improvement in the ratio related to capital issuances which temporarily heightened both our MCCR and leverage ratios. In the second quarter, the repayment of CAD1 billion of maturing debt will reduce our capital ratio by approximately 8 points.

In addition, if the Company redeems, subject to regulatory approval, CAD450 million of preferred shares which will become redeemable at par in June, we would expect a further 3 point decline in the MCCR ratio.

We ended the quarter with a leverage ratio of 30.8%, down 190 basis points from the prior year, reflecting strong growth in our retained earnings. While we would expect some quarter-to-quarter variability in our leverage ratio, we are comfortable that it will continue to trend towards our long-term target of 25%.

Turning our focus to the operating highlights of our divisions, we begin with the Asia Division on slide 17. Core earnings actually increased 11% over the prior quarter and 18% over the first quarter of 2013 on an apples-to-apples basis when you adjust for the impacts of currency, dynamic hedging costs, and the sale of our Taiwan insurance business.

We are also encouraged by the improved momentum in Asia insurance sales due to double-digit growth in most territories and the successful launch of new enhanced corporate term products in Japan. Japan insurance sales alone increased 43% compared with a year ago. This percentage increase reflects that sales in the first quarter of 2013 were somewhat reduced after the higher than normal activity due to announced price increases in 2012 and the first quarter falls in the last quarter of Japan's fiscal tax year.

Wealth sales of \$1.5 billion continue to be at the level seen in the second half of the year but declined 37% from the very strong prior year results as rising interest rates and market uncertainty continue to impact some markets.

Turning to our Canadian Division's operating highlights on slide 18, core earnings were largely in line with the prior quarter as higher insurance new business strain on seasonally lower sales and unfavorable policyholder experience was partly offset by lower expenses. Insurance sales of CAD134 million were significantly lower than the prior year period, reflecting our disciplined pricing approach in our market-leading Group Benefits business and normal variability in the large case segment. Excluding Group Benefits, insurance sales increased 8%.

Retail insurance sales however were up 9% as the market reacted favorably to our actions to improve our competitive positioning. We achieved record wealth sales of CAD3.4 billion, an increase of 18% versus the prior year. The robust sales were driven by record mutual fund sales and strong growth in Group Retirement Solutions, which more than offset lower Manulife Bank lending volumes.

Moving on to slide 19 and the highlights for the US Division, core earnings were \$339 million, down 3% from the fourth quarter reflecting an unfavorable swing in policyholder experience and higher new business strain due to lower insurance sales, which offset a favorable one-time tax item and higher fee income.

First-quarter insurance sales of \$108 million were down 24% from the prior-year period reflecting pricing actions taken last year. We introduced product enhancements and more competitive pricing this quarter, which we expect will improve sales.

Wealth sales rose 13% driven by robust mutual fund sales growth and meaningful sales in our midmarket 401(k) product, partly offset by competitive pressures in our core 401(k) market. We have strengthened our product in the core 401(k) small case market to improve our competitiveness through more targeted pricing, fee transparency, and additional investment options.

So in conclusion, in the first quarter of 2014, we generated strong core earnings and net income, achieved strong wealth management sales, improved life insurance sales momentum in Asia and Canada, reported a capital ratio of 255%, and delivered our 22nd consecutive quarter of record funds under management.

This concludes our prepared remarks. Operator, we will now open the call to questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions). Joanne Smith, Scotia Capital.

**Joanne Smith** - Scotiabank - Analyst

Good afternoon. I have a couple of questions. First on the Asia sales improvement, I think it's really great that sales improved in Japan on the new product launches. I would like to hear what you are doing elsewhere in the region and if you could talk about ex-Japan and Hong Kong, what's going on with sales in the rest of the region and what you think the outlook is and how the competitive market is?

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**Bob Cook** - Manulife Financial Corporation - SEVP and General Manager, Asia

Sure, Joanne. This is Bob Cook. I think our outlook for most of the countries in Asia is pretty positive although Japan was the highlight for the quarter. We did have strong results from virtually all countries with the exception of Singapore. I think looking forward we have a wide range of product launches in Hong Kong in the second quarter, which I think should keep their momentum going strongly for the rest of the year. So I'm certainly optimistic about that.

I think we also had some very positive results in the first quarter from China and again, I think a series of planned product launches going forward will help us maintain that momentum as well.

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**Joanne Smith** - Scotiabank - Analyst

Thank you and then just on the US Retirement Services Business, Craig, I was wondering if you could talk about competition in the small case market and any seed pressure that might exist there. I've been hearing contradicting remarks from companies over the course of the conference call this quarter and I'm just wondering what your view is?

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**Craig Bromley** - Manulife Financial Corporation - SEVP and General Manager, US

Yes, this is Craig Bromley. We have seen contradictory results as well but from our business perspective, I guess we are looking at what we can control. We haven't seen the margin pressure that you are talking about. Margin pressure is kind of a constant in this segment and not just in the small case but across the board. But nothing particular this quarter or any new pricing actions by competitors or anything like that.

In terms of our sales, we are down a little bit against last year. I would say that for really 2013, we saw some slowdown in sales momentum coming off a strong 2012. We have taken a number of actions including the launch of our Signature 2.0 product and we expect to gain traction there as the year unfolds. So we don't have any particular concerns right now on the sales front or on the margin front.

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**Joanne Smith** - Scotiabank - Analyst

What about distribution, Craig? Just in terms of have you been expanding distribution? Is distribution of shelf space getting tougher to find? Maybe you could talk a little bit more about that.

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**Craig Bromley** - Manulife Financial Corporation - SEVP and General Manager, US

No, I wouldn't say it's getting tougher. We have a very good distribution footprint particularly for small case. We are expanding distribution because we are moving into the midmarket. We are really starting largely with the distributors we already operate through who operate in both segments. But we are starting to touch some new distributors that haven't traditionally done business with us, so we are expanding our distribution. I don't see distribution shrinking or shelves getting shortened at this time.

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**Joanne Smith** - Scotiabank - Analyst

Thanks very much.

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**Operator**

Mario Mendonca, TD Securities.

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**Mario Mendonca** - TD Securities - Analyst

Good afternoon. Throughout the press release you made reference to reducing pricing in the US or better competitive offering in Canada in Individual Life and even in the 401(k). Is there anything you can say, perhaps Steve, about strain going forward because it would seem that with long-term rates moving a little lower this quarter and what you are saying about pricing that we should expect strain to move higher?

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**Steve Roder** - Manulife Financial Corporation - SEVP and CFO

Thanks, Mario. Thanks for your question. I think previously we tried to give a sort of indicative run rate for strain and we indicated a number of around 70 per quarter and I don't think we have any change to that guidance. We are still comfortable with that guidance and I'd also remind everyone that that includes non-DAC-able wealth distribution costs within what we currently define as strain. But no, I don't think there's any fundamental change.

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**Mario Mendonca** - TD Securities - Analyst

So what is the offset then? If you expect to reduce pricing or enhance features or what have you to pick up additional sales, what is offsetting --? How could strain not have changed your guidance to this?

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**Steve Roder** - Manulife Financial Corporation - SEVP and CFO

So there are all kinds of factors within the overall strain calculation and I think you are highlighting one particular aspect. Maybe I will just ask Cindy if there's anything she would like to add to that.

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**Cindy Forbes** - Manulife Financial Corporation - EVP and Chief Actuary

Sure. Thanks, Steve. It's Cindy. We would see an offset in part through volumes, volume increases that would offset the impact of slightly lower margins. Some of the products have positive margins and also there's an expense contribution from new sales and so that would offset.

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**Mario Mendonca** - TD Securities - Analyst

So the comment about not seeing strain increase from here is somewhat dependent on picking up additional volume?

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**Cindy Forbes** - Manulife Financial Corporation - EVP and Chief Actuary

It would be somewhat dependent on increased volumes.



**Mario Mendonca** - *TD Securities - Analyst*

Okay, one other quick question. With reference to surplus earnings, in the presentation you refer to mark-to-market gains that drove a higher surplus earnings number this quarter. Are there any gains, any of these mark-to-market gains treated as items of note when you arrive at your core number or are they all part of core?

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**Steve Roder** - *Manulife Financial Corporation - SEVP and CFO*

No, they are non-core.

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**Mario Mendonca** - *TD Securities - Analyst*

So how much would that --? And so you are saying those gains in earnings on surplus that caused the number to be higher, they are non-core. Where could you refer to that number? In your items of note, which number is it?

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**Steve Roder** - *Manulife Financial Corporation - SEVP and CFO*

It's within investment experience.

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**Mario Mendonca** - *TD Securities - Analyst*

Okay, that's helpful. I would normally think of investment experience as being something connected to changes in assets backing your liabilities. So maybe just to finish that question up, what would that amount be that belonged in earnings on surplus? The gains that is?

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**Steve Roder** - *Manulife Financial Corporation - SEVP and CFO*

Around CAD60 million, something of that order.

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**Mario Mendonca** - *TD Securities - Analyst*

CAD60 million pretax?

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**Steve Roder** - *Manulife Financial Corporation - SEVP and CFO*

Yes.

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**Mario Mendonca** - *TD Securities - Analyst*

Okay, thanks.

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**Operator**

Darko Mihelic, RBC Capital Markets.

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**Darko Mihelic** - *RBC Capital Markets - Analyst*

Thank you, I wanted to circle back on Asia. And just -- I understand it was a good improvement in the core earnings but I'm looking at topline sales and agent count and I was wondering maybe, Bob, if you can speak to the decline in agent numbers in Asia and whether or not you expect that agent count to turn the corner and actually go higher.

And I guess further to that, I think you outlined some strength in China and Hong Kong but maybe perhaps you can talk about Indonesia as well in terms of sales.

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**Bob Cook** - *Manulife Financial Corporation - SEVP and General Manager, Asia*

Sure, in terms of agent count, there's really two things happening that are kind of slowing the growth. One is in Indonesia, where we have kind of been going through I guess what I would describe as a periodic cleanup program of addressing some unproductive agents and just cleaning things up. As I say, it was something we would probably do every year or two.

The other one though that is perhaps more material is in China where we have consciously made more of a strategic shift to slowing down recruitment in China. We are not alone. Several of our foreign JV competitors have done the same thing and I think we all reached the same conclusion that in the current economic environment in China, we were just experiencing too much churn in the agency force and that a better path to growth would be to focus on additional training to improve the productivity of our existing core agents. And that is in fact what happened.

As I mentioned earlier, we had a good sales quarter in China despite not increasing the number of agents in China.

In terms of your comments in Indonesia, Indonesia did have a very strong year-over-year growth in sales once you adjust for currency and a big chunk of that came from the bank channel, both our principal relationship with Bank Danamon as well as the variety of other distribution agreements we have with both local and foreign banks in Indonesia all delivered outstanding results in the quarter and was a major driver of the success that we experienced in Indonesia.

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**Darko Mihelic** - *RBC Capital Markets - Analyst*

Okay, thank you.

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**Operator**

Robert Sedran, CIBC.

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**Robert Sedran** - *CIBC World Markets - Analyst*

Good afternoon. I'd just like to return back to the issue of the price declines and strain, in Canada in particular I guess. Is the feeling that the decline in price has put you in line with the market or ahead of where the market -- or below I guess where the market is from a pricing perspective?

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**Marianne Harrison** - *Manulife Financial Corporation - SEVP and General Manager, Canada*

It's Marianne Harrison from the Canadian Division. It puts us in line with the market. We had done some -- probably four or five -- increases over the last couple of years and the more recent one I would say at the beginning of last year. We didn't see the competition follow, so the change that we made in the third quarter of last year brought us in line with competition.

**Robert Sedran** - CIBC World Markets - Analyst

Okay, thank you. Steve, just on the policyholder behavior issue, I guess there was the swing from quarter to quarter. Is that just normal volatility from quarter to quarter or is there perhaps something predictive in there? Can you give us a little bit of more information on which product that might have been and what the outlook might be for that going forward?

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**Steve Roder** - Manulife Financial Corporation - SEVP and CFO

Sure, we had in Q4 we actually had favorable experience, and in Q1 we had unfavorable experience producing that swing. There was some special factors in Q4 which we talked about at the time. In Q1, we had one particularly large claim that cost us just shy of \$20 million so that constituted a fair amount of the adverse experience in this quarter. So I would just put it down to normal variability in the policyholder experience, Rob.

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**Robert Sedran** - CIBC World Markets - Analyst

Okay, thank you. Quick last one I hope. Just on the capital position and you always get asked about dividends and buybacks and all that kind of thing. I'm just wondering at what level you might consider removing the discount from the DRIP and perhaps starting to buy the shares in the market rather than issuing them from Treasury or whether for the foreseeable future we should see the share count kind of drip higher, if you will.

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**Steve Roder** - Manulife Financial Corporation - SEVP and CFO

It's something that we occasionally look at. We do keep it under consideration. Last time we looked at it we concluded that we should maintain our current position. I don't think there's any change to that right now, so nothing more to say on that at the moment.

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**Robert Sedran** - CIBC World Markets - Analyst

Thank you.

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**Operator**

Tom MacKinnon, BMO Capital Markets.

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**Tom MacKinnon** - BMO Capital Markets - Analyst

A question for Bob Cook with respect to Asia wealth sales. The wealth sales are kind of trending the second half of last year but you certainly had a lot of success with some hot products in the first half of last year. Can you maybe update us on any potential product repositioning here in Asia to kind of reignite some of the wealth management sales?

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**Bob Cook** - Manulife Financial Corporation - SEVP and General Manager, Asia

Okay, Tom. Not much news to report on Japan. Japan was probably the biggest driver of the reduction in wealth sales to the kind of \$1.5 billion a quarter that we've had for the last three quarters. And the success that we had prior to that was largely driven by a hot fixed income product and when the Abe Government came in, the asset class of favor in Japan switched dramatically to Japanese equities, both fund products and direct investment in the Japanese stock market. That has not shown any sign of changing. And unfortunately the way we distribute our product in Japan, all of our distributors basically manufacture Japanese equity products of their own so they don't need that from us. So I don't see any short-term shift in that.



There is a possibility of a shift in the other big decline year-over-year, which was in Indonesia. That was largely driven by local circumstances and there is some prospect that with the apparent resolution of the next government being favorable to the business climate that that could lead to improved investor sentiment in that market and help our business there. But that may be more in the second half of the year.

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**Tom MacKinnon** - *BMO Capital Markets - Analyst*

So are you suggesting that it was an industry issue, some of the slowdown in wealth sales in Indonesia?

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**Bob Cook** - *Manulife Financial Corporation - SEVP and General Manager, Asia*

Yes.

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**Tom MacKinnon** - *BMO Capital Markets - Analyst*

Okay and then just one quick follow-up I guess for Craig. This is unlike a lot of other conference calls. We are all asking the division people questions here, so that's good. But you used to reposition a lot of the portfolio into kind of a lower risk profile product and now it's like you are trying to introduce much more of a competitive product. Is it suffice to say that the competitive product that you are building up, I think it's the Index UL, is that still a low risk profile product? How can you make us feel comfortable that as a result of being more competitive you are still maintaining your proper risk profile?

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**Craig Bromley** - *Manulife Financial Corporation - SEVP and General Manager, US*

Yes, so we did do a substantial change in our portfolio and that really hasn't changed. The Index UL doesn't have a particularly greater risk profile than other products that we offer. The types of changes that we are talking about making here in terms of increasing our competitiveness are not major structural changes. They are really more tweaking things like portfolio rates for our UL products and some tweaks on sort of caps and floors on our indexed product.

So they are really not fundamental changes or we are not trying to become all of a sudden a lot more competitive through taking more risk.

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**Donald Guloien** - *Manulife Financial Corporation - President and CEO*

Tom, I'm going to take the opportunity here, Donald Guloien -- Mario and Robert and yourself were asking a similar question -- that we are not moving off the preferring margins to market share strategy but at the limit you get some -- a little bit of tweaks, as Craig said, can make a big difference when you get to some point where you're just slightly off the competitive mark. That is exactly what was done in Canada and that is what is being contemplated in the United States.

And at that sort of point of inflection, if you end up having your sales go up as a result of our fairly minor adjustment in the price, you make a lot more money overall, hence Steve's observation on the not strain likely to go up.

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**Tom MacKinnon** - *BMO Capital Markets - Analyst*

Thank you.

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**Operator**

Humphrey Lee, UBS.



**Humphrey Lee** - UBS - Analyst

Good afternoon, guys. Just as a follow-up question on Asia wealth sales, I think in the press release you mentioned that your current marketing strategy, current sales level a little bit. I was just wondering if Bob can talk a little bit on the second quarter to date in terms of how sales are progressing and what you are seeing in Asia?

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**Bob Cook** - Manulife Financial Corporation - SEVP and General Manager, Asia

Humphrey, we are having some trouble hearing you. There's a break in the line. I don't know if you are using a cell phone but if you can go --

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**Humphrey Lee** - UBS - Analyst

Is it better now?

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**Bob Cook** - Manulife Financial Corporation - SEVP and General Manager, Asia

Yes, that's a lot better.

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**Humphrey Lee** - UBS - Analyst

Okay, just wanted to have a follow-up question on Asia wealth sales. You mentioned in the press release that market uncertainty hurt your overall sales a little bit. I just want to ask Bob to see in terms of second quarter to date, has he seen anything -- any improvement in that regard and how sales are trending overall?

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**Bob Cook** - Manulife Financial Corporation - SEVP and General Manager, Asia

I don't really have any comment on second quarter to date.

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**Humphrey Lee** - UBS - Analyst

Okay, then maybe I'll ask another question to Craig. In terms of the mutual fund sales in the US being very strong, do you think the current level is sustainable and or if there's any kind of possible leverage to drive higher in the near future?

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**Craig Bromley** - Manulife Financial Corporation - SEVP and General Manager, US

Yes, I think the sales have been gaining momentum for a number of years now and we still have the same strong product lineup and distribution footprint that we did before. Obviously markets can impact how sales go, so if there was a dramatic change in the equity markets or something, that could impact our sales profile. But right now I don't see any of that coming and so I wouldn't expect any major changes.

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**Humphrey Lee** - UBS - Analyst

Okay, then in terms of the Retirement Life Services, the sales mix, can you provide like a mix between small case and mid-case for the quarter?

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**Craig Bromley** - *Manulife Financial Corporation - SEVP and General Manager, US*

We said that our sales in the mid-case market are material now and that's probably the first time that we have been able to say that. You know we just launched the product last year. Still however, the vast majority of our sales are in the small case market in our traditional core markets and that will continue to be the case for the foreseeable future. We've been in the small case market for over 20 years. We've been in the mid-case market for a year and we are still continuing to build out features to make that product more attractive in the midmarket. So it is pretty much tilted towards small case still.

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**Humphrey Lee** - *UBS - Analyst*

Okay, got it. Thanks.

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**Operator**

Steve Theriault, Bank of America Merrill Lynch.

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**Steve Theriault** - *BofA Merrill Lynch - Analyst*

Thanks very much, a couple questions maybe first for Craig. I think we have covered off the 401(k) but I saw a mention of a new retail long-term care offering you expect to launch in Q2. Can you give us some of the details and expected impact there?

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**Craig Bromley** - *Manulife Financial Corporation - SEVP and General Manager, US*

Well, we have made some changes to our pricing. I think that's probably what you are referring to, which will be launching in Q2. Prices will go up and we have obviously gone out for rate increases on the in-force and we are restoring margin in the new business as well.

I guess in terms of what the impact might be on sales, obviously if we are increasing prices, that's not a tailwind. That's more of a headwind. I guess it really depends on what our competitors do as well because I think a number of them are contemplating or completing the same types of actions. So it remains to be seen.

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**Steve Theriault** - *BofA Merrill Lynch - Analyst*

Okay, and then for Steve or maybe for Cindy in referring to slide 13 where you have new business embedded value for the wealth side, going back to your comments, what is it about the mix change in wealth that led to flat new business embedded value despite pretty good sales growth both quarter-on-quarter and year-on-year? Is it Canada -- sorry is it US versus Asia? If you can help me understand that a bit better I'd appreciate it.

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**Cindy Forbes** - *Manulife Financial Corporation - EVP and Chief Actuary*

It's Cindy, Steve. The mix change was really a reduction in pension sales year-over-year in Hong Kong, very good employer choice cash flows and sales of prior year still good this year but not as strong. That was offset by improved mutual fund sales but not a complete offset and then quarter-over-quarter, we had strong sales in RPS, 401(k) in the fourth quarter and so the mix change there is largely pension again but more the US.

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**Steve Theriault** - *BofA Merrill Lynch - Analyst*

Okay, thank you.

**Cindy Forbes** - *Manulife Financial Corporation - EVP and Chief Actuary*

Again, strong mutual fund sales quarter-over-quarter as well but didn't fully offset the pension impact.

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**Steve Theriault** - *BofA Merrill Lynch - Analyst*

I'm sorry -- just the pension impact is primarily Hong Kong on the negative side or entirely Hong Kong?

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**Cindy Forbes** - *Manulife Financial Corporation - EVP and Chief Actuary*

It's primarily Hong Kong year-over-year so when you look back to Q1 2013 versus Q1 2014.

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**Steve Roder** - *Manulife Financial Corporation - SEVP and CFO*

Steve, if you recall the employee choice arrangement was introduced in late 2012 in Hong Kong so we had a strong run-up in 2013 and we led on net cash flows I think throughout 2013 but there's obviously some tapering off of the amount of money moving around the market so it's as anticipated.

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**Steve Theriault** - *BofA Merrill Lynch - Analyst*

Yes, that makes sense. Thanks for the color.

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**Operator**

Peter Routledge, National Bank Financial.

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**Peter Routledge** - *National Bank Financial - Analyst*

Good afternoon. A question on holding company financial flexibility. You've got a lot of it with MCCSR as high as it is. What I'm trying to reconcile is a great deal of financial flexibility with the decision to issue capital this quarter in effect to replace or at least partially replace the redemptions you have coming up this quarter. Why not just pay down the capital that's maturing this quarter and drive your leverage ratio down just straight away?

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**Steve Roder** - *Manulife Financial Corporation - SEVP and CFO*

Okay, so you're right, Peter. We obviously do have a lot of financial flexibility and I think we made it pretty clear we are not necessarily going to replace all the debt that falling due and we may indeed redeem preference shares. So over time we would expect our leverage ratio to come down through earnings accretion but also because we will take some of the leverage off the table. That would be our intent.

We have pre-financed the majority of the debt falling due and the press that are up for redemption in June this year but by no means all of it. And so you can anticipate subject to regulatory approvals as we state that this would play towards reducing our leverage ratio over Q2 and as we go forward.

So I guess that's the color I would put on it but the other factor that's out there and this does not mean to say that we are going to refinance everything that comes due but if we're going to do some refinancing we would rather refinance when rates are low than when they are high. So there's that other sort of overlay of consideration that we have to take into account.

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**Peter Routledge** - *National Bank Financial - Analyst*

That's fair, and this is a good news story. I don't mean to quibble but all this capital -- if I can call it excess capital at the operating company, wouldn't that be -- couldn't you use that more productively either through share repurchases or maybe to do an acquisition? How are you -- you've got this block of capital that you can use and I'm wondering why you haven't used it yet I guess?

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**Donald Guloien** - *Manulife Financial Corporation - President and CEO*

Peter, Donald here. I think the most dangerous thing is when you've got excess capital burning a hole in your pocket and encouraging people to reduce the amount of discipline they exhibit towards acquisitions. You know, contrary to some of the coverage that you might've read a few years ago, we were never capital-constrained in terms of doing deals. We look at deals and turn them down. They have been matters that we just didn't feel met the hurdle rates that would do the job for our shareholders.

We look at every deal as if we had to finance it with capital. We will do that regardless of what our stock price is or regardless of how much excess capital that we have. You're quite right if you can't deploy the capital in terms of funding organic growth, making investments for the future, or doing strategic acquisitions, you should give it back to shareholders and my personal bias is towards dividends rather than stock buybacks although stock buybacks do help the share price in the short term and they certainly help people who hold options. But my bias is toward something more longer, sustainable, and frankly more in the best interests of shareholders, which is dividends.

But the best use as you have identified is either funding organic growth, investments in the future, or acquisitions. But we will never let a high capital ratio encourage us to make deals that otherwise we wouldn't do. That is a very dangerous proposition. You are not suggesting it but I just want to make very clear that our discipline will stay the same regardless of what our capital ratio is.

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**Peter Routledge** - *National Bank Financial - Analyst*

Is it fair to say that in subsequent quarters the Board meets, share repurchases are a very real alternative, where maybe when things weren't quite as rosy in terms of outlook, that might not have been the case?

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**Steve Roder** - *Manulife Financial Corporation - SEVP and CFO*

I think it's fair to say that if you wind the clock back a year, I don't think there was a lot of discussion at the Board around the question of capital deployment because when our leverage ratio was closer to 34 than 30, then that was probably not the top of the agenda.

As we move forward, we obviously have to keep these things under consideration but the leverage ratio still remains important and it's probably worth just reminding you that we have got over CAD2 billion of debt falling -- maturing in 2015 in Q2 and Q3 2015. Also the headline MCCR ratio of 255% is, as we have stated, assuming that we redeem the preference shares which will be subject to regulatory approval, then you can anticipate 11 points coming off that as well. So we have to balance all these aspects.

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**Peter Routledge** - *National Bank Financial - Analyst*

Okay, just one final, Steve. Macro hedge and URR assumption change costs are going in the right direction. Is there a point in the future where we will see them both at zero?



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**Steve Roder** - Manulife Financial Corporation - SEVP and CFO

I think at some stage the URR ultimately would become positive. It's now I think 25 but it will take time to get there because of the averaging effect.

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**Peter Routledge** - National Bank Financial - Analyst

I guess what I was asking for the ASB changes might get you to zero faster than --?

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**Steve Roder** - Manulife Financial Corporation - SEVP and CFO

That's right so that comment is assuming that the world -- everything else remaining unchanged, as it were, but while obviously things could change if the new regulations play into that.

On the macro hedge question, maybe Rahim might just want to just make a comment.

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**Rahim Hirji** - Manulife Financial Corporation - EVP and Chief Risk Officer

Sure, we expect our macro hedges cost to decrease over the next few years but I wouldn't expect it to be sort of reducing dramatically over the next year or so. I think it's sort of a steady decline from where it is today.

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**Peter Routledge** - National Bank Financial - Analyst

Okay, thank you.

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**Operator**

Doug Young, Desjardins Capital.

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**Doug Young** - Desjardins Capital - Analyst

Good afternoon. I guess my first question, it was referenced a few times in the call that Asia core earnings were up 18% and that excluded a number of items. One of the items just was the dynamic costs and I understand that your macro costs are in the corporate sector and your dynamic costs are in your divisional. I just want to confirm when you are backing that out, that is the one-time cost associated with setting up the reserve related to the dynamics, so that is a one-time item. I just wanted to confirm that.

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**Steve Roder** - Manulife Financial Corporation - SEVP and CFO

No, it's actually -- it's a geography issue within the income statement, so the macro hedge costs are within the corporate line and the dynamic within the individual divisions. So as we shift from macro to dynamic, when we are able to do that, then that does distort our quarter-on-quarter run rate analysis if you like. So this quarter the impact of the macro dynamic shift I think is worth around CAD12 million. So that's -- essentially penalized the division and benefited the corporate.

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**Doug Young** - Desjardins Capital - Analyst

I guess my question is, is that an ongoing cost then every single quarter?





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**Steve Roder** - Manulife Financial Corporation - SEVP and CFO

Yes, we have hedging costs every quarter, so it's just a shift in geography.

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**Donald Guloien** - Manulife Financial Corporation - President and CEO

But the absolute cost of dynamic hedging is a number that is variable based on a whole host of factors, so you can't say that the absolute number is a constant. It's a completely variable number based on all the elements that go into its calculation.

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**Doug Young** - Desjardins Capital - Analyst

Okay, I may come back to you on that. Just maybe this is for Donald, when I do look at your CAD4 billion earnings target for 2016 and I look where your core earnings were as you guys -- I do the numbers for this quarter, the CAGR to get there is 14%. And then if I assume you can get your E&E benefits closer to 10%, when you look at that, Donald, does that at all concern you? How do you get from here to there? I do understand that it's probably going to be more back-end weighted.

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**Donald Guloien** - Manulife Financial Corporation - President and CEO

Well, I'm not going to tell you the absolute trajectory. That would get into the guidance game, but I think it's sort of a 16% compound growth rate and which happens to be exactly what we did last year. And I'm feeling very comfortable -- that not a prediction. As I have said many, many times before, what I care about is not whether we get CAD4 billion right on the money or CAD4.1 billion or CAD4.2 billion or CAD3.8 billion or CAD3.9 billion but that we are on a trajectory so that the next year it will be a nice incremental over that and the trajectory, that 2018 will be a nice increase over 2017. And we are on a very, very healthy path towards that. Again, no projection but we are moving in the very right direction.

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**Doug Young** - Desjardins Capital - Analyst

So you are still comfortable with that target range?

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**Donald Guloien** - Manulife Financial Corporation - President and CEO

I'm comfortable. Steve is comfortable. The management team is comfortable. Now that doesn't mean there's any prediction. We are not in the guidance game, so as you know, a variety of factors could derail that, but we feel as of this moment quite comfortable. And again all I care about is getting close to that target and ensuring that we have the right momentum that 2017 and 2018 are progressively better. That's the thing I care most about, but I have a lot of comfort with that target, not to say that it's a guarantee.

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**Doug Young** - Desjardins Capital - Analyst

Okay, thank you very much.

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**Operator**

Joanne Smith, Scotia Capital.

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**Joanne Smith** - Scotiabank - Analyst

Just a question on how much of the earnings are redeployed into organic growth. So I'm looking at the leverage and the strategy is to reduce leverage through earnings primarily and so that tells me that the cash that you are generating from your earnings is going someplace else. So does that mean that all of the cash that you are generating from earnings is going into organic growth opportunities or investing in the business or what else can you tell me about where the cash earnings are going?

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**Steve Roder** - Manulife Financial Corporation - SEVP and CFO

It's Steve. I guess first of all as I have said earlier on, we are not going to refinance all the debt that is falling due. I am sure we will take some of that off the table and we may redeem prefs as well, so that would be another utilization.

Yes, we are reinvesting into the business and yes, we have to consider other forms of redeployment and we've talked about those on this call, whether that be as Donald's reference to potential future dividend increases and the like, so there are all those sort of factors to take into consideration. We would definitely be happy to find acquisitions that satisfy our strict criteria and particularly, we believe that our major shareholders will be supportive of that particularly those that could be financed internally.

So there are all sorts of factors we have to take into consideration.

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**Joanne Smith** - Scotiabank - Analyst

Okay, thank you.

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**Operator**

Tom MacKinnon, BMO Capital Markets.

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**Tom MacKinnon** - BMO Capital Markets - Analyst

My question has been asked and answered, thanks.

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**Operator**

Mario Mendonca, TD Securities.

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**Mario Mendonca** - TD Securities - Analyst

Good afternoon. On the macro hedging, I saw that the notional went up and I understand Japan was weak this quarter and that's probably what necessitated it. But it's a little different from how I understood that trade-off between macro and dynamic would play out. So my understanding was that if rates were to deteriorate once you put on the dynamic hedging, there was no need to go back to macro. So can you help me think through where did my thinking go wrong?

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**Rahim Hirji** - Manulife Financial Corporation - EVP and Chief Risk Officer

I think that's absolutely true that when we switch from macro to dynamic, our intention is not to take off our dynamic hedges and move business back into our macro hedging program. But for the business that we are looking overall in terms of managing our earnings sensitivity through our



macro program, to the extent that we have market movements in Japan in particular with a volatile first quarter, we did put on more positions in terms of managing our overall sensitivities to equity markets.

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**Mario Mendonca** - *TD Securities - Analyst*

So is it fair to say that in the very near term, we could actually get an increase in the expected cost of macro hedging because of the small lift this quarter?

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**Rahim Hirji** - *Manulife Financial Corporation - EVP and Chief Risk Officer*

Based on markets so far, I won't expect it to be material.

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**Mario Mendonca** - *TD Securities - Analyst*

Okay, then a question that is similar to Doug's but not on earnings so much just more on ROE. Warren's business has generated an awful lot of these investment gains over the last 12 months, which I guess is good, but it has added materially to the book value which makes getting to that 13% ROE target or outlook, whatever we're calling it, a little harder to get to.

So when you think about that 13%, Donald and Steve, does that still make sense in the context of how fast your book value has grown?

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**Donald Guloien** - *Manulife Financial Corporation - President and CEO*

We can't -- we rerun the numbers from time to time but both Steve and I feel pretty comfortable with that, Mario.

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**Mario Mendonca** - *TD Securities - Analyst*

Thank you.

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**Donald Guloien** - *Manulife Financial Corporation - President and CEO*

But your observation is absolutely true. But -- and it's not lost on us, but all things considered, we feel still pretty comfortable.

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**Mario Mendonca** - *TD Securities - Analyst*

Thanks.

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**Operator**

Thank you. There are no further questions registered at this time. I would like to turn the meeting back over to Ms. Asher.

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**Anique Asher** - *Manulife Financial Corporation - VP of IR*

Thank you, operator. We will be available after the call if there are any follow-up questions. Have a good afternoon.



**Operator**

Thank you. The conference has now ended. Please disconnect your lines at this time. We thank you for your participation.

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